

Forms of Public Government Decentralization in the Russian Federation and Intergovernmental Fiscal Relations at the Subnational Level

By “intergovernmental fiscal relations at the subnational level” are meant the issues of assignment of revenue sources and expenditure responsibilities as well as those issues of fiscal capacity regulation that arise between any levels of public government within regions. But before proceeding to subnational tiers of government and relations among them, let us quote some figures illustrating the extent of inter-budgetary monetary flows in the whole of the Russian Federation.

According to the estimations of the Fiscal Policy Center, the following amounts were remitted from the federal budget to the regional level in 1999: 364 billion Rubles of shared federal taxes; 44 billion Rubles of transfers from the federal Fund for Financial Support of Regions; about 20 billion Rubles through other channels (in form of budget loans, financing of earmarked programs and mutual settlements). Hence, the total amount of monetary flows between the federal and regional governments made up about 430 billion Rubles, or one third of the consolidated budget of the Russian Federation. Regional consolidated budgets comprised over 60 percent of funds obtained through intergovernmental channels (resources received by regions from the extra-budgetary funds were not taken into account). Regional budgets in their turn transferred 234 billion Rubles to municipalities, of which 150 billion Rubles were tax transfers (tax sharing) and 84 billion Rubles were allocated in form of grants. The above amount accounted for about 70 percent of aggregate local (subregional) budgets in the Russian Federation.

The current budgetary system of the Russian Federation is built in such a way that involves no problems with the identification of the parties to IGFR within the federal center/RF subjects context. Corresponding directly to these two tiers of government are the two levels of the budgetary system, whose relations are regulated by the budget and tax legislation of the Russian Federation.

On the contrary, the subnational level presents quite a different picture of intergovernmental relations. The federal legislation on IGFR between a RF subject and local governments provides no clear definition for those authorities that may become partners of a RF subject in intergovernmental relations within a region. It should be noted that under the current RF tax and budget legislation and the Federal Law On General Principles of Local Self-government Organization in the Russian Federation there are quite a number of eligible candidates to fulfill this purpose.

The tax and budget legislation of the Russian Federation establishes tax and expenditure responsibilities for the three levels of public government. As a result, a three-level budgetary system has been formed in Russia. At the same time, the RF legislation on bodies of state power and local self-governments provides for a possible formation of additional levels of public government. Currently, the administrative and territorial organization issues at the regional level are regulated by the Federal Law On General Principles of Organization of Legislative (Representative) and Executive Bodies of State Power in the RF Subjects and the Federal Law On General Principles of Local Self-government Organization in the Russian Federation. Owing to the contradictory nature of some provisions of the above laws, the Constitutional Court of the Russian Federation issued a number of rulings where it provided important interpretations of the issues in connection with the organization of local governments.

Ambiguous interpretations of the current legislation result in various types of local public administration in different regions of the Russian Federation:

Type I One-tier structure of state power of a RF subject and one-tier structure of municipal bodies of power (at the level of large cities and raions or at the level of sub-raion settlements)

Local bodies of self-government are for the most part formed on the basis of large cities and raions in the traditional administrative-territorial division. Municipalities enjoy the fiscal rights envisaged by the RF legislation for the third-tier of the budgetary system. Their fiscal relations with regional bodies of state power (i.e. amounts of financial assistance and tax sharing) are designed by regional authorities. In a number of regions the one-tier regional administration coexists with municipalities organized at the sub-raion level, on the basis of small towns and rural settlements. In this case the raion link is absent and the regional administration has to deal directly with several hundreds of municipalities.

In order to execute a municipal budget in RF subjects with one-tier municipalities on the basis of large cities and raions, sub-municipal bodies are appointed from the above, to which expenditure plans are forwarded.

Type II Two-tier structure of state power of a RF subject and one-tier structure of municipal bodies of power

This structure is similar to the previous one except that municipalities formed at the below-raion level are deprived of some rights and powers, fiscal ones in particular, established for them by the federal legislation. The authority to set local taxes is vested in territorial branches of the regional administration that have no elected bodies. Budgets of municipalities are incorporated in the regional budget in the form of expenditure plans.

Type III One-tier structure of state power of a RF subject and two-tier structure of municipal bodies of power

The first level of local government includes big cities and raions (i.e. it corresponds to the traditional territorial and administrative hierarchy); the second level is represented by governments formed on the territory within the jurisdiction of the local government of the first level and includes sub-raion cities and lesser settlements or their associations. Local residents elect both the first-level and second-level governments. Local governments of the first level engage in direct financial relations with the regional authorities. Financial relations between localities of the second level and the regional authorities are indirect and go through local governments of the first level. Local governments of the first level are responsible, *inter alia*, for the distribution of regional grants to localities of the second level and for splitting the sharing rates of shared taxes from the regional budget. In fact, first-level local governments perform functions of bodies of state power of the region vis-à-vis local governments of the second level.

If the second-level municipalities cover the entire territory in the jurisdiction of the first-level municipality, the latter usually is made responsible for maintenance of social infrastructure facilities providing services to the entire population of the area. Local taxes in this case should be delineated between the two tiers of local governments; however, the usual practice for a first-tier government is to set uniform local tax rates for all municipalities within its jurisdiction. If second-tier municipalities represent individual inclusions in the territory of the first-tier locality, the latter is responsible for the performance of functions of local self-government in the territory outside the jurisdiction of second-tier municipalities. Local taxes in this case are imposed by local self-governments of both levels.

At the same time the second-tier municipalities in a number of RF subjects have no budgetary rights and are provided at best with expenditure plans from first-tier municipalities.

The above forms of local self-government organization can make up different combinations in different subjects: e.g. of 295 municipalities of Tyumen Oblast, 4 have been formed at the level of large cities, 2 – at the level of raions with the rest set up at the level of small townships below raions. In Vladimir Oblast, 18 municipalities set up at raion level have a two-tier structure with the other 7 municipal entities having a one-tier type of organization. The second-tier municipalities in Vladimir Oblast are individual populated areas that have opted for local autonomy. However, regional authorities are unwilling to recognize them as full-fledged participants in intergovernmental fiscal relations¹ and delegate to the first-tier bodies of local self-government the authority to regulate their fiscal capacity.

At present, there are about 29,500 local administrations in Russia, of which 12,261² are officially registered as municipal entities with only 11,691 having elected representative authorities³, only 11,209 municipalities are endowed with municipal property and only 4,400 have fully independent budget.⁴

¹ In other words, they don't set shares of regulating taxes for them nor do they directly distribute transfers to them.

² Formation of Local Self-government in the Russian Federation, Goskomstat, September 2000 (in Russian).

³ For instance, in the Ingush Republic heads of municipalities have been appointed by decrees of the Republican President.

⁴ The information was obtained by the Fiscal Policy Center through a survey of regional financial authorities.

Table 1. Types of Public Government in RF Subjects

Type I a One-tier structure of state power of a RF subject and one-tier structure of municipal bodies of power (at the level of large cities and raions)

№	Region	Number of municipal budgets and municipalities	№	Region	Number of municipal budgets and municipalities
1	Aginsk-Buryat AO	39	27	Ingush Republic	6
2	Arkhangelsk Oblast	26	28	Republic of Karelia	19
3	Belgorod Oblast	22	29	Republic of Komi	21
4	Volgograd Oblast	39	30	Republic of Mari El	17
5	Vologda Oblast	28	31	Rostov Oblast	55
6	Jewish AO	6	32	Ryazan Oblast	29
7	Ivanovo Oblast	27	33	Samara Oblast	37
8	Irkutsk Oblast	37	34	Saratov Oblast	41
9	Kaliningrad Oblast	22	35	Sakhalin Oblast	19
10	Kaluga Oblast	45	36	Sverdlovsk Oblast	72
11	Kamchatka Oblast	9	37	Smolensk Oblast	27
12	Kemerovo Oblast	35	38	Taimyr AO	4
13	Kirov Oblast	45	39	Tver Oblast	43
14	Komi-Perm AO	7	40	Tomsk Oblast	20
15	Kostroma Oblast	30	41	Tula Oblast	26
16	Krasnodar Krai	48	42	Udmurt Republic	31
17	Leningrad Oblast	29	43	Ulianovsk Oblast	24
18	Murmansk Oblast	24	44	Ust-Orda Buryat AO	6
19	Nenets AO	21	45	Khanty-Mansi AO	22
20	Novgorod Oblast	22	46	Chita Oblast	34
21	Omsk Oblast	33	47	Chuvash Republic	26
22	Perm Oblast	41	48	Chukotka AO	9
23	Primorsky Krai	34	49	Evenk AO	3
24	Republic of Altai	11	50	Yamal-Nenents AO	13
25	Republic of Buryatia	23	51	Yaroslavl Oblast	19
26	Republic of Dagestan	52			

Type I b One-tier structure of state power of a RF subject and one-tier structure of municipal bodies of power (at sub-raion level)

№	Region	Number of municipal budgets and municipalities
1	Orenburg Oblast	579
2	Penza Oblast	406
3	Tyumen Oblast	295
4	Stavropol Krai	304

Type II Two-tier structure of state power of a RF subject and one-tier structure of municipal bodies of power

№	Region	Number of territorial state budgets at local level	Number of municipal budgets	Number of municipalities
1	Kabarda-Balkar Republic	10	5	136
2	Karachai-Circassian Republic	10	4	85
3	Kurgan Oblast	26	2	459
4	Kursk Oblast	33	5	510
5	Novosibirsk Oblast	45	5	454
6	Republic of Adygeya	8	2	55
7	Republic of Bashkortostan	64	5	983
8	Republic of Kalmykia	14	3	116
9	Republic of Tatarstan	48	7	934
10	Republic of Sakha (Yakutia)	35	2	2
11	Republic of Tyva	19	1	1
12	Republic of Khakassia	?	51	96

Type III One-tier structure of state power of a RF subject and two-tier structure of municipal bodies of power

№	Region	Number of municipal budgets		Number of municipalities
		First level	Second level	
1	Astrakhan Oblast*	13	141	154
2	Bryansk Oblast	31	43	74
3	Vladimir Oblast	26	48	74
4	Moscow Oblast	69	7	76
5	Republic of Mordovia*	25	444	469
6	Pskov Oblast	26	2	28
7	Republic of North Osetia	9	4	114
8	Chelyabinsk Oblast	39	15	325
9	Altai Krai	71	0	766
10	Amur Oblast	28	0	340
11	Voronezh Oblast	34	0	547
12	Koryak AO	5	0	33
13	Krasnoyarsk Oblast	57	0	574
14	Lipetsk Oblast	20	0	324
15	Magadan Oblast	9	0	64
16	Nizhni Novgorod Oblast	52	0	597
17	Oryol Oblast	27	0	267
18	Tambov Oblast	30	0	352
19	Khabarovsk Krai	19	0	224

* Second-level municipalities cover the entire territory in the jurisdiction of the first-level municipality.

Source: Number of Municipal Budgets - a survey of financial authorities of RF subjects conducted by the experts of the Fiscal Policy Center.

Therefore, the actual structure of public government in the Russian Federation has four levels while the budget and tax legislation covers only three levels of the budgetary system. As a consequence, the system of public finance is not efficient. The federal legislation envisages tax and expenditure responsibilities for a single local government; as a result, large cities (such as capitals of RF subjects), raions that include a great number of small towns and settlements as well as rural settlements, provided they are registered as municipalities, have the same responsibilities.

The amounts of revenue received by municipalities from those taxes that are assigned to them by the current federal legislation are not enough to cover their expenditure responsibilities. Thus, only 13 percent of expenditure needs of an average statistical municipality were covered in 1999 by local tax revenues. The share will become even less following the annulment of a number of local taxes and fees by the RF Tax Code. At the same time the budget legislation assigns significant expenditure responsibilities to municipalities, including those in connection with education and healthcare that are guaranteed by the Constitution. Thus, the expenditure responsibilities of sub-raion municipalities do not correspond to their status. At the same time, revenue sources of large cities and raions do not meet the expenditure responsibilities assigned to them.

The problem is aggravated by those norms of the federal legislation that allow formation of local self-governments within any territorial boundaries. The practice when sub-raion municipalities are formed spontaneously or in accordance with political biases of regional authorities leads to the following negative consequences:

- the size of a territory within the jurisdiction of a municipality (and, consequently, the coverage by public services) does not correspond to the expenditure and functional responsibilities of the local self-government assigned to it by legislation;
- the fragmented and unevenly distributed revenue base of local governments does not conform to the territorial distribution of needs in public services;
- the managerial staff of local governments does not cope with the assigned responsibilities;
- as a consequence, local governments and population seek for support from outside.

Expenditure Responsibilities of Local Governments

In view of the absence of a clear assignment of expenditure responsibilities between the regional and local governments, disputes often arise as to what budget is responsible for a particular expenditure item and where its financing should come from. Such unclear assignment of expenditure responsibilities together with great expenditure norms that are enacted by superior governments (federal and regional mandates) result in a situation when local governments perform functions of territorial branches of their regional government rather than render quality public services to population in their jurisdictions while local budgets are transformed into transit accounts. When expenditure responsibilities are assigned, little attention is paid to the dependence of public service effectiveness on the level of budget from which the costs of these services are covered, no distinction is made between such functions as setting standards of public service supply, financing and actual service rendering. Accordingly, there is neither clear delineation among these functions nor assignment to the relevant tiers of government.

In practice, assignment of expenditure responsibilities very often comes to assignment of property since it is not the rights and responsibilities associated with service rendering that are delineated but the responsibility for maintenance of social infrastructure facilities.

Functional Structure of Local Government Expenditures

The largest spending functions of local budgets are Housing and Utilities, Education and Healthcare (**Table 8**).

Table 8. Composition of local expenditures by function (percent), 1998 and 1999

Budget Classification Item (Function)	1998						1999
	By type of budget:					Share of function in aggregate subregional spending	Share of function in total subregional spending*
	Cities	Raions	Towns	Townships	Rural settlements		
Local government	3.9	7.3	4.6	6.8	12.1	5.3	5.7
Law enforcement, public order	1.6	1.2	1.6	0.5	0.2	1.4	1.6
Industry, energy, construction	0.8	5.4	0.5	0.4	1.1	2.1	1.4
Agriculture and fishing	1.4	1.6	0.4	0.5	0.2	1.4	1.8
Public transport, roads, telecommunications	4.9	1.2	1.2	0.4	0.1	3.5	3.1
Housing and utilities	34.6	23.8	37.8	28.0	10.4	30.3	27.4
Education	24.6	29.3	36.5	45.4	56.6	28.1	28.1
Culture, art and cinema	1.6	3.0	1.5	2.5	8.1	2.3	2.5
Healthcare and physical fitness	15.8	14.8	10.9	9.9	8.8	15.0	15.8
Welfare	5.4	7.6	3.2	1.7	1.7	5.7	5.5
Other expenditures	5.4	4.6	1.9	4.0	0.7	4.9	4.3
Total expenditures without budget loans	100.0	100.0	100.0	100.0	100.0	100.0	100.0

* Only aggregated data for all local governments are available for 1999.

Source: authors' calculations based on RF Ministry of Finance data.

Such heavy spending on housing and utilities is due to subsidized housing rents and utility charges. Since housing and utility subsidies only apply to municipal housing, they are a big spending category only in large cities, whereas in rural areas where the majority of houses are in private ownership the share of housing and utilities in total local spending is much lower.

For rural municipalities the largest spending function (accounting for more than half of all budget resources) is education.

Rural municipalities spend less on healthcare than other localities, as hospitals are for the most part located in cities – raion or regional centers, while rural localities mostly provide paramedic and obstetrical services.

Table 9 gives some idea of the degree of basic public services decentralization in the Russian regions. Let us note that the share of local budgets in consolidated regional healthcare spending is noticeably below the national average in regions with heavy fragmentation of local government. This is explained by the fact that hospital maintenance accounts for the largest portion of healthcare spending while hospital allocation to municipalities is extremely uneven owing to the latter's fragmentation. In such situation regional governments have to pay hospital maintenance costs from their budgets. On the contrary, schools and social centers are distributed in a more even manner and therefore in their case the above pattern is less noticeable. Thus, following the reorganization of local self-government structure in Tyumen Oblast when municipalities were set up according to the below-raion principle, the regional budget had to include in its balance-sheet most public institutions in raions. As a result, the local government share in the Oblast consolidated spending fell from 60 to 45 percent and the “decentralization campaign” announce by the Oblast governor turned into its very opposite.

Table 9. Degree of Decentralization of Basic Public Services: Regional and Local Spending Shares by Functions, 1999

<i>Region</i>	HOUSING AND UTILITIES		EDUCATION		CULTURE AND ART		HEALTHCARE AND FITNESS	
	% of region	% of municipalities	% of region	% of municipalities	% of region	% of municipalities	% of region	% of municipalities
Russian Federation	26.3	73.7	24.1	75.9	43.3	56.7	42.4	57.6
North								
Republic of Karelia	14.9	85.1	17.8	82.2	49.8	50.2	39.5	60.5
Republic of Komi	3.4	96.6	10.1	89.9	26.3	73.7	66.1	33.9
Archangelsk Oblast	7.5	92.5	8.1	91.9	28.9	71.1	35.7	64.3
Vologda Oblast	3.5	96.5	24.0	76.0	41.7	58.3	37.8	62.2
Murmansk Oblast	1.4	98.6	5.1	94.9	28.4	71.6	30.0	70.0
Nenets Ao	34.2	65.8	41.7	58.3	49.0	51.0	82.1	17.9
North West								
City of St.-Petersburg	97.9	2.1	99.4	0.6	99.0	1.0	99.4	0.6
Leningrad Oblast	2.1	97.9	11.5	88.5	30.4	69.6	47.3	52.7
Novgorod Oblast	14.5	85.5	9.9	90.1	16.2	83.8	50.9	49.1
Pskov Oblast	15.6	84.4	18.1	81.9	42.7	57.3	40.1	59.9
Center								
Bryansk Oblast	8.4	91.6	9.8	90.2	28.5	71.5	44.7	55.3
Vladimir Oblast	1.3	98.7	4.3	95.7	19.1	80.9	25.0	75.0
Ivanovo Oblast	0.6	99.4	8.1	91.9	31.2	68.8	26.7	73.3
Tver Oblast	2.3	97.7	9.3	90.7	31.2	68.8	39.8	60.2
Kaluga Oblast	4.9	95.1	18.8	81.2	40.6	59.4	32.4	67.6
Kostroma Oblast	21.0	79.0	11.4	88.6	30.4	69.6	30.8	69.2
Moscow Oblast	5.5	94.5	11.9	88.1	14.9	85.1	19.0	81.0
Oryol Oblast	49.6	50.4	20.7	79.3	37.2	62.8	36.2	63.8
Ryazan Oblast	15.8	84.2	13.4	86.6	30.1	69.9	41.1	58.9
Smolensk Oblast	7.1	92.9	16.9	83.1	32.4	67.6	23.4	76.6
Tula Oblast	5.1	94.9	8.3	91.7	26.4	73.6	24.0	76.0
Volga-Vyatka								
Yaroslavl Oblast	2.2	97.8	12.4	87.6	31.8	68.2	26.6	73.4
Republic of Mari El	7.9	92.1	25.0	75.0	40.4	59.6	30.9	69.1
Republic of Mordovia	22.7	77.3	15.7	84.3	39.8	60.2	32.4	67.6
Chuvash Republic	9.3	90.7	10.0	90.0	34.8	65.2	21.9	78.1
Nizhny Novgorod Republic	3.3	96.7	14.1	85.9	18.1	81.9	10.4	89.6
Kirov Oblast	7.4	92.6	7.0	93.0	20.5	79.5	28.0	72.0
Central Black Earth								
Belgorod Oblast	14.3	85.7	19.5	80.5	31.2	68.8	38.9	61.1
Voronezh Oblast	7.3	92.7	10.9	89.1	22.8	77.2	27.3	72.7
Kursk Oblast	10.3	89.7	12.6	87.4	63.6	36.4	43.4	56.6
Lipetsk Oblast	2.5	97.5	9.3	90.7	29.0	71.0	33.7	66.3
Tambov Oblast	1.3	98.7	9.6	90.4	28.2	71.8	40.2	59.8
Volga River Basin								
Republic of Kalmykia	50.2	49.8	10.6	89.4	33.1	66.9	77.2	22.8
Republic of Tatarstan	13.9	86.1	9.2	90.8	44.3	55.7	28.2	71.8
Astrakhan Oblast	10.2	89.8	18.2	81.8	45.1	54.9	34.4	65.6
Volgograd Oblast	6.0	94.0	13.5	86.5	30.8	69.2	16.8	83.2
Samara Oblast	3.3	96.7	40.6	59.4	28.8	71.2	75.9	24.1
Penza Oblast	16.2	83.8	44.1	55.9	56.9	43.1	55.7	44.3
Saratov Oblast	5.6	94.4	14.9	85.1	38.2	61.8	29.7	70.3
Ulianovsk Oblast	20.4	79.6	26.3	73.7	55.0	45.0	50.5	49.5
North Caucases								
Republic of Dagestan	21.7	78.3	14.9	85.1	35.1	64.9	81.0	19.0
Kabarda-Balkar Republic	53.5	46.5	24.7	75.3	40.8	59.2	40.6	59.4
Republic of North Osetia	11.9	88.1	19.8	80.2	72.9	27.1	54.3	45.7
Ingush republic	87.9	12.1	46.6	53.4	56.4	43.6	68.3	31.7
Krasnodar Krai	11.0	89.0	7.9	92.1	23.3	76.7	23.2	76.8
Stavropol Krai	35.6	64.4	15.3	84.7	23.1	76.9	24.3	75.7
Rostov Oblast	2.3	97.7	8.3	91.7	62.9	37.1	34.5	65.5
Republic of Adygeya	11.9	88.1	28.6	71.4	51.8	48.2	42.6	57.4
Karachai-Circassian Republic	34.1	65.9	10.5	89.5	31.2	68.8	41.5	58.5

<i>Region</i>	HOUSING AND UTILITIES		EDUCATION		CULTURE AND ART		HEALTHCARE AND FITNESS	
	% of region	% of municipalities	% of region	% of municipalities	% of region	% of municipalities	% of region	% of municipalities
Urals								
Republic of Bashkortostan	50.4	49.6	26.2	73.8	58.8	41.2	38.0	62.0
Udmurt Republic	9.0	91.0	9.7	90.3	22.9	77.1	28.1	71.9
Kurgan Oblast	5.1	94.9	17.1	82.9	23.5	76.5	34.1	65.9
Orenburg Oblast	37.7	62.3	45.0	55.0	60.4	39.6	56.2	43.8
Perm Oblast	2.6	97.4	9.6	90.4	29.1	70.9	26.1	73.9
Sverdlovsk Oblast	2.0	98.0	19.0	81.0	29.6	70.4	44.6	55.4
Chelyabinsk Oblast	5.2	94.8	12.8	87.2	29.2	70.8	16.8	83.2
Komi-Perm AO	8.3	91.7	11.1	88.9	27.8	72.2	45.7	54.3
West Siberia								
Altai Krai	5.9	94.1	8.9	91.1	26.1	73.9	21.7	78.3
Kemerovo Oblast	2.3	97.7	11.9	88.1	17.0	83.0	18.3	81.7
Novosibirsk Oblast	0.0	100.0	6.9	93.1	49.8	50.2	27.0	73.0
Omsk Oblast	32.9	67.1	42.1	57.9	61.1	38.9	46.3	53.7
Tomsk Oblast	3.9	96.1	19.5	80.5	30.9	69.1	39.5	60.5
Tyumen Oblast	19.3	80.7	19.9	80.1	50.7	49.3	62.1	37.9
Republic of Altai	30.3	69.7	21.8	78.2	24.0	76.0	55.7	44.3
Khanty-Mansi AO	12.1	87.9	9.5	90.5	8.6	91.4	14.2	85.8
Yamal-Nenets AO	1.5	98.5	13.8	86.2	21.8	78.2	34.6	65.4
East Siberia								
Republic of Buryatia	3.9	96.1	9.0	91.0	39.3	60.7	37.7	62.3
Republic of Tyva	13.9	86.1	11.6	88.4	33.7	66.3	46.1	53.9
Krasnoyarsk Krai	5.3	94.7	8.3	91.7	25.6	74.4	17.1	82.9
Irkutsk Oblast	3.4	96.6	6.5	93.5	63.6	36.4	19.0	81.0
Chita Oblast	3.9	96.1	17.1	82.9	37.7	62.3	44.1	55.9
Republic of Khakassia	10.8	89.2	13.2	86.8	26.5	73.5	29.7	70.3
Aginsk-Buryat AO	17.2	82.8	12.7	87.3	67.4	32.6	90.2	9.8
Taimyr AO	77.1	22.9	16.2	83.8	20.2	79.8	78.2	21.8
Ust-Orda Buryat AO	66.4	33.6	7.9	92.1	14.6	85.4	38.4	61.6
Evenk AO	6.3	93.7	27.4	72.6	50.7	49.3	60.4	39.6
Far East								
Republic of Sakha (Yakutia)	9.4	90.6	23.5	76.5	49.7	50.3	42.5	57.5
Primorsky Krai	1.4	98.6	11.3	88.7	18.4	81.6	36.2	63.8
Khabarovsk Krai	25.5	74.5	8.4	91.6	32.6	67.4	33.8	66.2
Amur Oblast	0.0	100.0	23.3	76.7	14.0	86.0	32.9	67.1
Kamchatka Oblast	4.5	95.5	11.4	88.6	27.8	72.2	26.1	73.9
Magadan Oblast	6.2	93.8	8.9	91.1	36.4	63.6	38.6	61.4
Sakhalin Oblast	5.4	94.6	6.4	93.6	38.0	62.0	25.0	75.0
Jewish AO	9.7	90.3	11.8	88.2	17.5	82.5	76.6	23.4
Koryak AO	8.6	91.4	15.9	84.1	25.6	74.4	18.7	81.3
Chukotka AO	7.4	92.6	7.6	92.4	17.4	82.6	37.1	62.9
Kaliningrad Oblast	4.8	95.2	5.7	94.3	36.9	63.1	31.6	68.4

Source: authors' calculations based on RF Ministry of Finance data.

Expenditure Norms

Unlike in many other countries, Russian legislation, in particular the Budget Code, contains references to federal expenditure norms (social standards) that must be observed by all levels of government while forming their budgets. But the system of such norms has not been approved nor even developed yet. Although the Russian Ministry of Economy and sector ministries have not given up their attempts to develop such a system, common sense suggests that it is hardly possible to develop a uniform system of expenditure norms for as big a country as Russia. Actually, only a few expenditure norms have so far been established at the federal level, and but for a few exceptions they are not mandatory spending standards, but reference standards used by higher level government for determining the allocation of fiscal capacity equalization transfers to localities.

At present the only effective norm set at the federal level under the Russian Government Decree is the *Uniform Schedule of Wages for Workers of Budget Organizations*. Workers of budget organizations are employees of all institutions funded from the budget of any level, including the local one, except for the administrative staff of governments.

Federal Mandates

The spending autonomy of local authorities is narrowly constrained by federal laws that entitle various population groups to benefits and subsidies, in other words, by the so-called federal mandates.

Benefits and subsidies to eligible population groups are prescribed in more than 150 federal legislative acts, of which 45 were passed before 1992, but still remain in effect. Local authorities are mandated to pay 37 types of subsidies from local budgets, with eligible groups covering a sizable portion of local citizenry, if not the entire population.

Responsibility for most of those entitlements and subsidies have been from the outset assigned by federal laws to local governments. Funding requirements of federal mandates, if they are all followed, are estimated to outrun all revenues, including transfers, of most localities. For instance, according to the estimates made by the officials of Kirovsky Raion, Leningrad Oblast, the funds needed to finance the mandates would more than exhaust all budget revenues available to the municipality. Reported budget revenues in 1997 were 16 percent less than the total estimated cost of federal mandates.

The Federal Law *On Financial Foundations of Local Self-government in the Russian Federation* (1997) provides that “bodies of local self-government shall be entitled to execute decisions of bodies of state power resulting in increase of expenditures or loss of revenues of local budgets within resources made available to them by way of compensation”. However, in the overwhelming majority of cases local authorities fail to prove inadequacy of funds transferred to them “by way of compensation” because, strictly speaking, this can be proven only where funds are transferred for particular purposes. In practice the amount of funds required for compensation is just “taken into account” in establishing rates of shared taxes or in determining total transfer amounts. Meanwhile, local authorities are sued by individuals for failure to pay the entitlements and often lose such court cases.

Examples of federal mandates include:

- wages of teachers, doctors, and certain other categories of budget employees
- payment of monthly child allowances
- subsidies relating to payment for housing, utilities, electricity, and fuel
- subsidies for fuel purchases by disabled persons
- monthly cash compensation to teachers for the cost of book purchases
- provision of free medicine to certain population groups
- payment of allowances to persons having custody over children
- free meals in schools and hospitals
- free milk products for children under 2 years of age
- free prosthesis for disabled persons
- burial subsidies
- subsidies for payment for telecommunication, municipal transport and certain other services for WWII veterans, old-age pensioners, families of WWII victims, victims of the Chernobyl disaster, families with many children, Heroes of the Soviet Union and Heroes of the Socialist Labor Movement, blood donors, military servicemen, police officers, customs officers, prosecutor’s office workers, court officers, tax police officers and traffic police officers.

The Law on 2001 Federal Budget provides for setting up of a so-called Compensation Fund within the Fund for Financial Support of Regions from which regions will receive resources to cover (in part or in full) their expenditures associated with execution of federal laws on monthly payment of child and invalid allowances. However, by no means all the regions finance these allowances from their budgets. Thus, in most of them child allowances are provided from local budgets without any compensation from the relevant regional budget. Instead, local needs in expenditures on child allowances are “taken into account” when financial assistance is distributed from the regional government. Nevertheless, since financial resources

from the Compensation Fund will be provided to regions in form of earmarked subventions the RF Ministry of Finance will be able to monitor their purposeful use, e.g. they will either be allocated to local budgets as earmarked subventions or paid directly from regional budgets. In both cases the burden of local budgets will become lighter.

Revenue Sources of Local Budgets

The process of local self-government formation in the Russian Federation was not accompanied by provision of greater authority to regulate fiscal capacity at the local governments' own discretion. At the same time, in most regions municipalities account for a considerable share of consolidated spending (see [Table 2](#)). Since local tax and non-tax revenue represent but an insignificant part in municipal expenditures, the vertical imbalance thus arising has to be covered by sharing rates of shared taxes and financial assistance that local governments receive from the regional budget ([Table 3](#)). Some 24 percent of local expenditures in 1999 were covered from regional resources (transfers, grants, subventions and mutual settlements). If we add to this tax sharing resources (at rates changed on the annual basis) and financial assistance from the higher governments, the figure will be 68 percent. Because sharing rates change from year to year, local governments cannot forecast their budget revenues and actually have no responsibility for formulation and execution of their budgets and, in the final analysis, for the quality and quantity of public services rendered to population.

Table 2. Distribution of RF Consolidated Budget Expenditures among Levels of Budgetary System, 1999

Year	Consolidated budget expenditures, percentage of GDP	Federal budget percentage share of RF consolidated budget	Regional budgets percentage share of RF consolidated budget	Local budgets percentage share of RF consolidated budget
1997	32.5	44.6	23.8	31.7
1998	27.9	45.9	24.2	29.8
1999	27.7	48.0	24.5	27.5

Source: authors' calculations based on RF Ministry of Finance data.

Table 3. Structure of Local Budgets Revenues in the Russian Federation, 1999

Revenue sources		Bln. Rbl.	%
Total local budgets revenues (1+2+3+4)		346.3	100.0
of which:			
1. Tax revenues		245.9	71.1
1.1	- local tax revenues	45.5	13.1
1.2	- revenues permanently assigned to municipalities by the federal legislation	47.4	13.7
1.3	- sharing taxes	153.0	44.2
2. Non-tax revenues		12.4	3.6
3. Earmarked budgetary funds revenues		4.0	1.2
4. Grants from higher governments		84.0	24.3
4.1	- grants and transfers	54.2	15.7
4.2	- subventions	9.4	2.7
4.3	- other	20.4	5.9

Source: authors' calculations based on RF Ministry of Finance data.

Local Taxes and Fees

Before 1998, when regions were authorized to introduce sales tax that replaced the majority of local taxes, most Russian regions levied 23 local taxes (see Table 7). Revenues from those levies in 1999 amounted to 13 percent of all revenues for municipalities.

With their rates virtually legislated by the federal government, local taxes, despite being numerous, failed to ensure fiscal autonomy for localities. Furthermore, the list of local taxes was exhaustive, i.e. no new taxes could be added by localities at their own discretion. Local governments could exercise some autonomy in setting the base and rates for a very limited number of taxes, such as the tax on construction of manufacturing facilities in health resort areas, fee for the right to engage in trade, fee for parking motor vehicles, racecourse participation fee, fee for the right to shoot movies and TV films, fee for street cleaning, and fee for setting up gambling businesses.

The "fee for street cleaning" levied on gross sales of enterprises had become a significant source of own budget revenue for a number of localities. In some cases revenues from the tax amounted to 25 percent of all tax collections, and, clearly, it was spent not only on street cleaning. In 2001 the Russian Government is planning to repeal all turnover taxes, including this

one, and compensate for resulting revenue losses by assigning to municipalities 5 percent of collections from the enterprise profits tax.

The regional sales tax replaces 16 local taxes, including those with respect to which localities exercised at least limited freedom in setting the tax base and tax rates. Instead, local governments are assigned 60 percent of sales tax collections that, as the practice shows, often fail to compensate for the loss of revenue from repealed local taxes.

Article 15 of the Russian Federation Tax Code that determines the list of local taxes and fees has not been yet put into effect. However, it is suggestive of federal legislators' intentions vis-à-vis local taxes. Thus, a list of local taxes contained therein includes only 5 taxes:

- land tax,
- personal property tax,
- inheritance and gift tax,
- advertisement tax,
- local license fees.

The said Article establishes that once a subject of the Federation puts into effect the Immovable Property Tax, the Land Tax and Personal Property Tax will cease to be levied for local governments in its jurisdiction.

Non-tax Revenues

The main sources of local non-tax revenues are:

- revenues from use of municipal property and activities,
- revenues from sales of municipal land and immovable property.

These revenues are an independent source of local budget revenues. Starting from 1999, the budget classification treats revenues from sales of public property as a source of deficit financing, because these revenue sources are not recurrent.

In addition to local tax and non-tax revenues mentioned above, the law *On Financial Foundations of Local Self-government in the Russian Federation* allows local governments to collect «lump-sum voluntary contributions from citizens in accordance with the municipal charter», or «self-imposed charges». The budget classification, however, does not allow to recognize these charges in total revenues. If municipalities collect these charges, the latter are probably used as a revenue source for forming extra-budgetary funds, rather than as a source of budget revenues.

Federal and Regional Tax Revenues Permanently Assigned to Local Budgets

Tax revenue assigned to localities on a permanent basis under the Federal Law On Foundations of the Tax System in the Russian Federation include:

- federal tax revenue from:
 - royalty (a fixed share set for each type of payment for subsoil resources),
 - stamp duty (100%),
 - state duty (100%),
 - inheritance and gift tax (100%),
 - income tax on persons engaged in individual entrepreneurial activities (100%),
- regional tax revenues from:
 - enterprise property tax (50%),
 - sales tax (60%).

Assigned tax revenues in 1999 amounted to 13.7 percent of all revenue for localities.

Shared Taxes at Rates Changed Annually

Shared taxes are a principal tool of intergovernmental fiscal regulation at the regional level and account for the largest amount of revenues distributed from regional budgets to localities.

Local revenues from shared taxes are general purpose grants extended from a higher level budget on a gratuitous basis, just like subsidies or equalization transfers. Sharing rates for taxes that are shared between the region and localities and a list of taxes that regions use for regulating fiscal capacity of municipalities in their jurisdictions are set by regional governments.

Taxes that regions can choose to share with localities include:

- the following federal taxes that the federation shares with the regions:
 - personal income tax,
 - enterprise profits tax,
 - excises assigned on share by the federal authorities to subjects of the Russian Federation;
- the following regional taxes:
 - enterprise property tax (within 50-percent share assigned to the regional level),
 - forest tax,
 - payment for water,
 - education tax,
 - sales tax (within 40-percent share assigned to the regional level).

Under the Law *On Financial Foundations*, the region can set different sharing rates of federal taxes for different municipalities, but the share of all localities in total collections from a particular federal tax that the region is allowed to retain in consolidated regional budget should not be less than a certain minimum which varies by type of tax:

- 50 percent for the personal income tax,
- 5 percent (of total collections) of the enterprise profits tax,⁵
- 10 percent for VAT,⁶
- 5 percent for excises on alcoholic beverages,
- 10 percent for excises on other goods.

However, the above minimum requirements provide no guidelines to municipalities for estimating their next year revenues from tax sharing, as the average sharing requirement can be met with a wide range of local sharing rate combinations, including the ones where some municipalities are allowed to retain 100% of shared taxes collected in their territories, and some are assigned 0 sharing rates.

The Law *On Financial Foundations* requires that local sharing rates be formula-driven and that shared taxes and equalization transfers be allocated to municipalities using a uniform methodology. These requirements imply that both regional/local tax sharing and equalization transfers to localities from the regional government are both general purpose regional grants, but transferred to localities through different channels. In practice, however, these requirements are not enforced, and regional authorities make no attempts to allocate those funds using a single equalization methodology.

Earmarked and General Purpose Grants

Grants to localities from the federal and regional budgets include equalization transfers (subsidies), subventions and mutual settlements.

Equalization transfers are distributed to localities for the sole purpose of fiscal capacity equalization, meaning that local governments are free to spend these revenues at their own discretion. Revenue sources of the equalization fund within the regional budget and the size thereof are determined by regional governments.

⁵ Starting from 2001, a local 5 percent enterprise profits tax will be collected.

⁶ Starting from 2001, all VAT revenues will be consolidated in the federal budget.

Under the Law *On Financial Foundations*, equalization transfers should be allocated across municipalities using a fixed formula, the parameters of which include the population size, the share of various age groups, such as pre-school and school age children as well as of pension-age individuals, in total population of a municipality, the level of per capita fiscal capacity before equalization and other local features. In practice in the majority of regions the distribution of equalization transfers is negotiated rather than formula-driven.

Subventions mean financial resources allocated for designated purposes for a certain period of time to municipalities from the federal or regional budget and subject to repayment to an appropriate budget in case of failure to use the same for the intended purpose within the established time-limit. The federal legislation sets neither the purpose for which regions should provide subventions to localities nor the procedure for regions to follow in distributing subventions among localities.

Regions rarely use subventions as a channel for transfer of financial resources to localities as this would immediately reveal inadequacy of amounts transferred. Instead, they try to get out of it with lame excuses that funds for execution of federal and regional mandates were taken into account in determining the size of equalizing transfers distributed to local budgets. When they are used, subventions from regional budgets are provided primarily for the execution of federal mandates,⁷ and sometimes for the executions of regional mandates.⁸

Another type of earmarked grants is “mutual settlements”. Mutual settlements are funds transferred by regional governments to localities to reimburse the latter for their cost increases or revenue losses brought about by decisions of the regional government made during the budget year, i.e. after local budgets were approved. Under the category of “mutual settlements” local budgets mostly receive funds for covering costs of maintenance of housing, utilities and other facilities transferred to municipalities. Besides, under this category localities may receive additional earmarked assistance (not provided for in the budget) for financing other types of spending as well as for writing off debts on budget loans. There is no prescribed method of allocating those additional financial resources across municipalities.

Methods of Intergovernmental Grant Allocation

Different regions use different approaches to allocating intergovernmental transfers to localities.

Most regions estimate expenditure needs and revenue capacity of localities and allocate transfers to cover the financing gap. These numbers are then negotiated between the region and individual localities: localities would present different figures to claim expenditure needs that are higher and anticipated revenue collections that are lower than regional estimates. In so doing both parties usually refer to historic tax collections and expenditures or estimates derived from previous years' data. As a rule, financial assistance is distributed to municipalities on the basis of the number of social infrastructure facilities in their jurisdiction. That is why local authorities are interested in maintenance of ineffective facilities, which has a negative impact on budget spending efficiency.

The lack of real revenue raising and spending autonomy weakens local governments' responsibility before their electorates and gives them an opportunity to blame higher governments for insufficient financing or laws that cannot be complied with. Soft restraints and the possibility to obtain additional funds from higher governments, provided local authorities persuade them to take into account their additional expenditure needs, makes ineffective

⁷ In Vladimir Oblast subventions from the Oblast budget in 1999 were provided first and foremost for payment of child allowances to low-income families, while in Leningrad Oblast – for payment of subsidies to eligible groups for housing and utilities and free medicines.

⁸ In 1999, subventions in Leningrad Oblast to local budgets were used to support the State Service of Medical and Social Examination. In Altai Krai local budgets received subventions for maintenance of inter-raion budget agencies.

management of financial resources rather profitable for municipalities. Large wage arrears or accounts payable become an additional argument for allocation of financial assistance.

This approach obviously discourages local tax efforts and prudent spending of local resources. Moreover, it creates incentives for local authorities to hide revenues in extra-budgetary funds to avoid reporting, and negotiate in-kind offsets with potential taxpayers to boost spending. Soft budget constraints permit local authorities to keep inefficient public facilities, overstaffed budget organizations and use inefficient technologies of public service provision.

Another problem has to do with the use of regional expenditure norms for the estimation of local expenditure needs by the regions for allocating equalization transfers. Several regions, including the Leningrad, Sverdlovsk and Moscow Oblasts, have established them in their laws. Rather than being standards for provision of public services to consumers, those norms are maintenance standards for service providing institutions. For instance, these are not financing norms per student, but expenditure norms per school that are applied regardless of whether a particular school is at all needed. Besides, expenditure norms are demand driven and disregard the actual affordability of norm-driven expenditures. The expenditure needs based on norms often exceed the available resources, hence regions eventually have to cut down expenditures borne out of a lengthy and labor-intensive calculation procedure. The failure to comply with norms that were fixed as laws also creates social tensions.

Some of the regions have attempted to develop formal methodologies for distribution of financial resources that instead of using historic data on previous years' actual expenditures and revenue collections will determine local expenditure needs and revenue potential for the coming year on the basis of certain objective criteria. However, unlike the federal government that had turned to the use of transparent formulas for transfer allocation in 1994 and since then scored an impressive progress in this area, governments of most regions either do not realize the need for formalization of intergovernmental fiscal relations or, even if they do, are incapable of solving the problem on their own for lack of expertise needed to develop an appropriate methodology.

In June 2000, the federal Ministry of Finance approved and circulated to financial departments of subjects of the Federation a document called *Provisional Methodological Recommendations for RF Subjects on Regulation of Intergovernmental Fiscal Relations* (hereinafter referred to as Recommendations). The Recommendations were developed by the RF Ministry of Finance in cooperation with independent experts⁹ and based on the experience of formalization of intergovernmental fiscal relations in advanced Russian regions (Leningrad Oblast, Vladimir Oblast), the international practice of intergovernmental fiscal relations and a requirement to apply formal methods in distributing fiscal grants as set out in the Law *On Financial Foundations*.

The Recommendations advise regional administrations to use the following guidelines for allocating grants:

1. the principle of balancing own revenues and “needs” of localities should be abandoned in favor of a formula-based equalization of per capita fiscal capacity;
2. instead of past revenue collections, endowment of municipalities with taxable resources should be used for estimating their revenue capacity;
3. in measuring per capita fiscal capacity, consideration should be given to objective differences in demand for public services and costs of providing them such as the demographics of the population, cost of living, duration of the heating season, population density, etc., while estimation of expenditure needs based on the existing social infrastructure should be abandoned;

⁹ The Fiscal Policy Center, Georgia State University and the Fiscal Reform in Russia Project sponsored by United States Agency for International Development.

4. amounts of shared taxes and equalization transfers to go to municipalities should be estimated within a single procedure.

There can be many ways of formalized distribution of financial assistance based on the above principles, and each region is free to choose the one that will suit it best.

Using a formalized methodology of allocation of financial resources will ensure predictability of transfer amounts, save time spent in agreeing local budget targets, create incentives for local governments to raise more revenues and for more prudent use of budget resources.

It should be emphasized that under the current federal legislation regional governments are free to choose the design of intergovernmental fiscal relations within their boundaries, while the federal government may not order but only advise. Nevertheless, many regions have shown interest in using new methods and are planning to start using formula-driven allocations already in 2001.

Equalization Efficiency

The efficiency with which regions equalize fiscal capacities of their municipalities is different and explained not so much by weak methodology but by a specific policy conducted by the region in question. Regional governments have to choose between two options: an equal access of residents of any municipality to public services and a policy when “wealthy” regions are allowed to retain part of regional and federal taxes collected in their jurisdictions, which is a stimulus for their further development, in contrast to the policy of leveling with its negative consequences.

In order to analyze the equalization efficiency, first per capita municipal own revenue capacity was calculated and then the revenue capacity of the same municipalities after tax sharing, equalization transfers and other funds of intergovernmental fiscal regulation were provided to them. The calculation results for 49 regions are shown in Table 5. The following figures provide an idea about the equalization situation: according to the estimation of the RF Ministry of Finance,¹⁰ in 2001 per capita fiscal capacity adjusted for the Budget Expenditures Index in the wealthiest RF subject (Yamal-Nenets AO) will be 45 times more than in the poorest region (Evenk AO). It is planned to reduce this gap up to six times after providing FFSR transfers to the regions. The degree of inequality of per capita fiscal capacity measured with Gini Coefficient was 0.64 before equalization transfers and 0.49 after their provision.¹¹ A comparison of these figures with those in Table 5 shows that as far as the ratio of per capita fiscal capacity of the wealthiest and poorest regions is concerned, the inequality among municipalities in some regions (e.g., in Moscow Oblast and in Khabarovsk Krai) is higher than the degree of inequality among the RF regions although, in terms of Gini Coefficient, the inequality among municipalities in any region does not reach the inequality among the RF regions (the Republic of Dagestan has the highest Gini Coefficient: 0.53). It should be noted that all the regions on which data are available are more successful in their equalization efforts vis-à-vis lower governments than the federal government doing the same with regard to the regions. However, this is not surprising since the federal Fund for Financial Support of Regions comprises only 11 percent of the total revenue capacity of the regions (gross tax resources plus FFSR) while the total amount of funds received by local governments through the channels of intergovernmental fiscal regulation (in form of tax sharing and grants from higher budgets, see Table 4) make up about 68 percent of their total incomes.

¹⁰ The Methodology and results of transfer calculations made by the Fund for Financial Support of Regions for 2001.

¹¹ According to the estimations of the Fiscal Policy Center. Cf. N. Barbasheva, *A Comparison of Regional Fiscal Capacity Equalization Following FFSR Transfers in 2000 and 2001*, www.fpcenter.org.

Table 3. Inequality of Municipal Fiscal Capacity across RF Regions before and after Equalization, 1999

		Ratio of per capita fiscal capacity of the wealthiest and poorest municipalities		Gini Coefficient before and after equalization	
		Before equalization	After equalization	before	after
1	Republic of Adygeya	3.67	1.42	0.20	0.05
2	Republic of Mordovia	3.75	2.03	0.24	0.08
3	Kirov Oblast	3.93	2.75	0.21	0.11
4	Republic of Mari El	4.51	1.72	0.21	0.09
5	Komi-Perm AO	4.62	1.62	0.30	0.08
6	Kabarda-Balkar Republic	4.70	2.54	0.24	0.12
7	Pskov Oblast	5.34	2.34	0.23	0.15
8	Vladimir Oblast	5.48	4.76	0.22	0.11
9	Kurgan Oblast	5.57	1.89	0.28	0.13
10	Kamchatka Oblast	5.64	6.50	0.1	0.15
11	Orlov Oblast	5.70	1.46	0.31	0.06
12	Kaliningrad Oblast	5.94	2.30	0.27	0.15
13	Bryansk Oblast	6.02	2.09	0.24	0.13
14	Vologda Oblast	6.38	2.09	0.30	0.14
15	Kaluga Oblast	6.38	4.28	0.21	0.13
16	Novgorod Oblast	6.53	1.85	0.31	0.10
17	Jewish AO	6.56	1.48	0.25	0.05
18	Altai Krai	6.58	5.60	0.34	0.10
19	Chuvash Republic	6.80	1.88	0.33	0.08
20	Ulianovsk Oblast	7.31	2.79	0.28	0.09
21	Kostroma Oblast	7.37	2.73	0.23	0.11
22	Republic of Karelia	7.67	3.07	0.25	0.17
23	Kemerovo Oblast	9.25	3.33	0.31	0.14
24	Republic of tatarstan	9.47	4.79	0.27	0.16
25	Karachai-Circassian Republic	9.74	1.47	0.35	0.08
26	Primorsky Krai	9.84	5.00	0.30	0.19
27	Omsk Oblast	9.86	2.93	0.30	0.16
28	Samara Oblast	10.65	2.49	0.27	0.17
29	Rostov Oblast	10.98	3.02	0.27	0.17
30	Belgorod Oblast	11.67	2.16	0.31	0.12
31	Chelyabinsk Oblast	12.54	3.36	0.31	0.17
32	Arkhangelsk Oblast	13.24	3.66	0.27	0.15
33	Republic of Khakassia	15.09	2.68	0.45	0.17
34	Amur Oblast	15.81	4.00	0.32	0.20
35	Chita Oblast	19.59	5.33	0.30	0.13
36	Irkutsk Oblast	20.07	2.24	0.30	0.18
37	Kursk Oblast	20.37	4.37	0.40	0.20
38	Astrakhan Oblast	21.31	2.32	0.38	0.08
39	Ivanovo Oblast	21.81	2.73	0.30	0.10
40	Republic of Buryatia	22.33	3.50	0.37	0.14
41	Leningrad Oblast	26.75	5.05	0.38	0.16
42	Republic of Komi	31.84	2.21	0.36	0.13
43	Republic of Bashkortostan	33.38	2.66	0.25	0.06
44	Sverdlovsk Oblast	34.76	16.49	0.27	0.12
45	Khanty-Mansi AO	35.92	4.58	0.31	0.18
46	Moscow Oblast	49.93	40.87	0.27	0.19
47	Khabarovsk Krai	65.50	12.15	0.19	0.2
48	Yamal-Nenets AO	85.86	3.44	0.47	0.19
49	Republic of Dagestan	130.00	3.02	0.53	0.12

Source: authors' calculations based on RF Ministry of Finance and State Statistics Committee data.

IGFR Reforms at the Federal Level as Compared with IGFR Reforms in the Regions

In spite of the obvious successes of the IGFR reform between the federal center and the regions, subnational fiscal relations need a thorough reconstruction. The IGFR reform initiated and carried out by the federal government will have a positive effect on regional finance. Regional governments will have to adopt a more rational attitude towards use of budgetary resources under the influence of a formalized procedure for providing financial assistance from the federal budget, stimulation of tax efforts and budget expenditures rationalization envisaged in the transfer formula. Nevertheless, this process is slowed down by the following intergovernmental problems at the federal level that have not been resolved yet:

- insufficient decentralization of public finance management and an extremely high share of conditional revenues and expenditures in the budgets of the RF subjects and municipalities (i.e. those that are determined by higher governments);
- a risk of greater control over regional and local governments rather than territorial branches of federal agencies owing to the federal center's desire to strengthen the vertical alignment of power;
- preservation of informal financial assistance channels;
- soft budgetary constraints;
- the yet unresolved problem of unfunded federal and regional mandates;
- lack of clearance in delineation of expenditure responsibilities between different levels of government;
- delineation of revenue sources that are inadequate for expenditure responsibilities;
- the number of the budgetary system levels envisaged by law does not correspond to the actual number of levels of public government;
- shortcomings of the public finance legislature.

As a consequence, despite some obvious achievements in the IGFR reform at the federal level, the situation with regional finance including intergovernmental relations in most RF regions does not correspond to the requirements of market reforms that are carried out and needs a radical change. Regional public finance is still characterized by the following features:

1. A lack of understanding of the role of public government in a market economy and the purpose of budget spending. Instead of such functions as provision of access to services and goods that have no market demand though are socially important, efforts are made to create a favorable business climate, to prevent private business negative impacts on the environment and population, to redistribute people's incomes along equalization lines and to secure stable conditions for economic and social development.
2. Instead of performing functions associated with provision of public services and goods, regional governments are busy in governing the whole of economy in their jurisdictions. The state is not very active in withdrawing from business and giving an opportunity to the private sector to produce market goods and services. While pursuing populist aims, regional governments use a considerable part of budget funds to support ineffective businesses both through direct subsidies and various privileges and benefits.
3. Irresponsible attitude to regional and federal finance owing, in the first place, to soft budgetary constraints and considerable imputed expenditures. A possibility to receive additional, not envisaged by budget, money as a result of actual excess spending of budgetary funds results in less responsibility for collecting own budgetary revenues and pursuing a prudential spending policy.
4. Adherence of regional governments to the old-fashioned system of centralized management. Regional finance is viewed and managed as a single centralized system, its main function being to finance current social infrastructure facilities irrespective of their regional or

municipal jurisdiction. The process of regional financial assistance allocation to local governments is based on negotiation skills rather than on a formalized method. Also, instead of objective criteria, such as revenue capacity and unit costs of budget expenditures in a territory, subjective factors are taken into consideration.

5. Lack of confidence on the part of regional governments in the capability of lower governments to use financial resources with due responsibility. This is further enhanced by a mismatch of revenue sources and staff capacity of local governments to responsibilities assigned to them. As a result, though most governors recognize the advantages of the new formalized model of fiscal relations between the federal center and the regions, they more often than not adhere to an opposite model of relations between regions and municipalities giving preference to the so-called paternalistic model.
6. A lack of stability in the allocation of financial assistance mechanism. This is caused not only by the fact that in most cases intergovernmental relations are based on negotiations but also by the instability of the national tax and budgetary system. The efforts aimed at reforming the system result in annual changes in revenue composition of subregional budgets.

The legislature on public finance and budgetary system that is far from perfect also contributes to low effectiveness of regional finance and intergovernmental relations. Also, this legislation contradicts the legislation on the administrative and territorial system, local government, social guarantees etc.

The current *budget legislation* does not allow for a proper alignment of responsibilities or jurisdictions among the levels of government. Governments' responsibilities to provide goods and services at the expense of budget funds are substituted with responsibilities to maintain agencies accommodated in buildings and constructions transferred into ownership of a relevant government. But even such assignment turns out to be ambiguous from the point of view of delineation of individual types of expenditures. In most cases the role of expenditure responsibilities is played by obligations that were imputed by higher governments but not adequately funded at the same time. Besides, the practice of assigning individual functions to different levels of government contradicts the rules of a most rational system of public service provision.

The *tax reform* that has been carried out during recent years addresses the taxpayer in the first place. It is practically of no importance for the recipients of taxes, i.e. for the way tax revenues are entered into the different levels of the budgetary system. The present model of differentiation of taxes into federal, regional and local does not correspond to the actual system of expenditure subdivision. The volume of intergovernmental monetary flows tends to grow owing to the allocation of tax revenues to the different levels of the budgetary system in accordance with the Tax Code. The primary reason for this is the reduction of own revenues of local governments caused by the abolition of a number of local taxes.

Among other factors that have a negative impact on intergovernmental fiscal relations and the state of regional finance are the shortcomings of the current *law on the administrative and territorial system*. The fact that public government in the Russian Federation has four and even five levels has not been recognized and thus the provisions of the Tax and Budget codes cover only three levels of the budgetary system. This also adds to ineffective assignment of expenditure responsibilities and revenue sources at the subregional level. The imperfections of the above law are also responsible for a common mismatch between tax capacities of jurisdictions at the different levels of government and expenditure responsibilities assigned to them.

Unfortunately, the *local government legislation* that is invaluable for the development of a civic society and social responsibility very often generates a parasitic attitude and irresponsibility of municipal authorities. Being deprived of real expenditure and revenue powers, local government becomes a fiction. Most of those functions that are assigned to municipal

governments differ from local functions in developed economies. In the Russian Federation, local authorities are in fact guarantors of the responsibilities of all levels of public government.

The sizes of social benefits and support provided to individual categories of the population and envisaged by the *law on social guarantees to the population* do not agree with the revenue capacity of the national consolidated budget. Besides, although this is a federal law it makes lower governments responsible for its compliance. Even in those cases when the assignment of responsibilities is accompanied by allocation of federal funds, the latter often appear to be insufficient for proper execution of such responsibilities. At the same time this cannot be proved in court owing to the imperfection of the relevant legislation.

Recommendations on Improvements of the RF Budgetary System at the Subregional Level

As has been demonstrated above, the actual structure of public government in the Russian Federation has four levels while the budget and tax legislation covers only three levels of the budgetary system. As a consequence, the system of public finance is not efficient. The federal legislation envisages tax and expenditure responsibilities for a single local government; as a result, large cities (such as capitals of RF subjects), raions that include a great number of small towns and settlements as well as rural settlements, provided they are registered as municipalities, have the same responsibilities.

The amounts of revenue received by municipalities from those taxes that are assigned to them by the current federal legislation are not enough to cover their expenditure responsibilities. Thus, only 13 percent of expenditures of an average statistical municipality were covered in 1999 by local tax revenues. The share will become even less following the annulment of a number of local taxes and fees by the RF Tax Code. At the same time the budget legislation assigns significant expenditure responsibilities to municipalities, including those in connection with education and healthcare that are guaranteed by the Constitution. Thus, the expenditure responsibilities of sub-raion municipalities do not correspond to their status. At the same time, revenue sources of large cities and raions do not meet the expenditure responsibilities assigned to them.

The problem is aggravated by those norms of the federal legislation that allow formation of local self-governments within any territorial boundaries. The practice when sub-raion municipalities are formed spontaneously or in accordance with political biases of regional authorities leads to the following negative consequences:

- the size of a territory within the jurisdiction of a municipality (and, consequently, the coverage by public services) does not correspond to the expenditure and functional responsibilities of the local self-government assigned to it by legislation;
- the fragmented and unevenly distributed revenue base of local governments does not conform to the territorial distribution of needs in public services;
- the managerial staff of local governments does not cope with the assigned responsibilities;
- as a consequence, local governments and population seek for support from outside.

It is recommended to solve the problem by providing a legislative status to the forth level of the budgetary system in compliance with the fourth level of public government. It is suggested that the additional level of the budgetary system is formed at the sub-regional level while its specific forms with all the attributes (first of all, appointments by election and budgetary powers) will be within the scope of authority of the appropriate region or regulated by the federal legislation (in which case the latter will be amended as necessary). In any case, the amendments in the following areas of the federal legislation will be recommended:

- the RF subjects are to be authorized to delegate their tax responsibilities (i.e. to allocate tax sources and to set tax rates) and the corresponding expenditure responsibilities to the lower levels, or

- a priori delineation of revenue sources and expenditure responsibilities between the third and forth levels of the budgetary system should be made.

As a result, a RF subject, in accordance with the current legislation, will be able to choose the organizational form of its sub-regional governments:

- a two-tier system of state power and one-tier municipalities (i.e., elective state power in raions and, possibly, in large cities to be paralleled by municipal governments responsible for the issues other than those guaranteed by the State), or
- one-tier state power of the RF subject and two-tier municipal governments.

The main difference between the two is the way the scope of responsibilities of the “medium” level of regional government will be determined: whether it will be the law of a RF subject (in the first case) or the opinion of the population as stipulated by the Federal Law On General Principles of Local Self-government Organization in the Russian Federation.

The IGFR between the medium and the bottom level of public government in a region might be regulated by its framework laws while the medium government will also retain certain powers in this respect.

The laws on administrative and territorial structure that are in force now in most RF subjects have no practical importance for the organization of local governments. Public law does not even define the administrative and territorial division and its role in public government organization. The only clarification on it is contained in the Ruling of the RF Constitutional Court of January 24, 1997, where it is specified that the administrative and territorial division form a territorial basis for setting up local representative and executive authorities in the regions. No local bodies of state power may be established in those territories that do not have the status of an administrative-territorial entity. However, no region so far has created representative bodies of state power at the sub-regional level. Accordingly, the object to be regulated by such legislation is absent from the RF subjects.

This should be a genuinely effective law that will have an influence on the formation of **subnational** governments and, accordingly, on the budgetary system of the RF subjects. The Constitution (Charter) of a RF subject should provide a list of entities within its jurisdiction, be it raion (city) bodies of state power or municipalities of the first level. These entities of the RF subjects will be the IGFR partners of the regional governments at the regional level.

The RF subjects will be recommended to formulate their own administrative and territorial division based on the most rational organization of public government aimed at effective rendering of public services.

Thus, when taking decisions on the administrative-territorial boundaries (be it bodies of state or municipal power) it is recommended to take into account the size of the area where public services will be rendered by a budget organization (or by a body of local self-government) most effectively.

It should also be kept in mind that territorial fragmentation (when jurisdictions become ever smaller) usually adds to the uneven tax base distribution across municipalities. This means both an uneven distribution of wealthier population and an uneven location of legal entity taxpayers across municipalities. Usually, larger jurisdictions include both wealthy and poor areas whose tax input is counterbalanced. As a rule, expenditure needs of such municipalities are also counterbalanced: poorer areas have higher expenditure needs because their population requires more public assistance and services.

The way in which such differences across jurisdictions influence the financial base of local governments depends on the tax system and the model of tax revenue distribution across local governments.

Western federative states provide several models of public government organization at the local level and their financial relations with the higher tiers of government. Most federative states have a two-tier system of local governments and the sizes of jurisdictions of both levels may vary from country to country. Of the main importance are the issues of compatibility of sizes of local jurisdictions to revenue sources and expenditure responsibilities assigned to them.

The reform of the budgetary system at the regional level in accordance with the above principles and recommendations will make it possible to do the following:

- assign to different levels of the budgetary system their individual expenditure responsibilities and revenue sources;
- form territorial boundaries for regional governments of the medium level (at this level the Constitutional guarantees regarding education and healthcare services will be fulfilled) with a view of maximum compatibility of available revenue sources to their expenditure responsibilities (for instance, a raion and its cities could be united into a single municipality);
- resulting from this, the amounts of financial assistance from the regional budget for fiscal capacity equalization purposes will be decreased;
- increase the liability of each level of government for the revenue and expenditure responsibilities assigned to them;
- promote actual participation of residents of municipalities in budget finance management.

To summarize the above, one may state that today about half of tax revenue of the RF consolidated budget and some 60 percent of expenditures account for subnational (regional and local) budgets. In this respect Russia yields to no other federalist country and even surpasses them as far as the local government share (25 percent) is concerned. Nevertheless, it is too early to speak about real decentralization of public government in Russia.¹²

¹² According to the IMF data, in mid-1990s the share of subnational budgets in the USA was 46 percent, of which local budgets accounted for 20 percent; in Canada, the figures were 54 and 12 percent and in Germany, 53 and 16 percent accordingly.